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No. 92-319

IN THE
Supreme Court of the United States
OCTOBER TERM, 1992

BOARD OF COUNTY COMMISSIONERS OF SAN JUAN COUNTY,
Petitioner,
v.

LIBERTY GROUP, A California Limited Partnership; NORMAN ANDREW GURLEY; LIBERTY PARTNERS, INC., A California Corporation; F.M.G. PARTNERS, A California General Partnership; CHESTER ARTHUR WALKER, JR.; DOYLE LAVERNE HOLMES; ROBERT CLAYTON HOLMES; STEVE RAY HOLMES; LIBERTY CAPITAL MARKETS, INC., A California Corporation; PRUDENTIAL-BACHE SECURITIES, INC., A Delaware Corporation,
Respondents.

On Petition for Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

1. Whether an individual Limited Partnership defendant, whose enterprise affairs were conducted through racketeering activities be immune from prosecution under 18 U.S.C. 1962(c), Racketeering Influenced Corrupt Organizations Act ("RICO"), because the person charged must be distinct from the enterprise which profited from its own racketeering activities.

2. Should the person-enterprise rule, as interpreted by a number of lower courts and the Tenth Circuit's interpretation in the case at bar be abandoned and should the Courts instead apply established criminal law principles to determine an entity's liability under RICO.

3. Should the Courts, by artificially construing the RICO statute, be allowed through these narow, restrictive judicial determinations, to develop and apply a doctrine that either partially or completely precludes entity liability under RICO and thereby avoid the congressional intent in enacting RICO.

4. The Trial Court correctly instructed the jury on the requisite mental state for liability required under a Rule 10b-5 claim promulgated under the Securities and Exchange Act of 1934. 17 C.F.R. Section 240. 10b-5(b).

5. That, even if the instruction was in error, did the defendant make a proper objection to the instruction as required by Fed. R. Civ. P. Rule 51.

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OPINIONS BELOW

The May 28, 1992 Opinion of the United States Court of Appeals for the Tenth Circuit is reported at Board of County Commissioners of San Juan County v. Liberty Group, 965 F.2d 879 (10th Cir. 1992) and is reprinted in Appendix A. The prior opinion of the United States District Court for the District of New Mexico is not reported and is also reprinted in Appendix B.

JURISDICTION

The judgment of the Court of Appeals was entered May 28, 1992. The jurisdiction of this Court is invoked pursuant to 28 U.S.C. 1254(1).

STATUTES AND FEDERAL RULES OF CIVIL PROCEDURE INVOLVED

This case involves the Racketeering Influenced Corrupt Organizations Act, 18 U.S.C. Section 1962(c), which provides as folows:

> "18 U.S.C. Section 1962(c)
>
> . . .
>
> (c) It shall be unlawful for any person employed by or associated with any enterprise engaged in, or the activities of which affect interstate or foreign commerce, to conduct or participate, directly or indirectly, in the conduct of such enterprise's affairs through a pattern of racketeering activity or collection of unlawful debt."

The full text of 18 U.S.C. Section 1962 is set out in Appendix D, Page 32a.

> "18 U.S.C. Section 1961(4)
>
> (4) 'enterprise' includes any individual, partnership, corporation, association, or other legal entity, and any union or group of individuals associated in fact although not a legal entity;"

The full text of 18 U.S.C. 1961 is set out in Appendix D, Page 34a.

The case also involves the Fed.R.Civ.P. 51, which provides as follows:

> "*Fed.R.Civ.P. 51*
>
> . . . No party may assign as error the giving or the failure to give an instruction unless that party objects thereto before the jury retires to consider its

verdict, stating distinctly the matter objected to and the grounds of the objection."

The full text of Fed.R.Civ.P. 51 is set out in Appendix D, Page 38a.

STATEMENT OF THE CASE

In June of 1986, the County, through its then County Treasurer, Ron Ashcroft (Ashcroft), began using Liberty Group, a California Limited Partnership, as its broker dealer for the investment of County's surplus funds in Government guaranteed securities. R. 6, Page 75. Liberty Group, acting through its account executive, who handled County's account, commenced "churning" the account, TR. Vol. II, Pages 162-163, charging excessive markups ranging from 3.3% to 45.3%. TR. Vol. II, Pages 124-176. Liberty Group and Gurley knowingly failed to disclose these markups to County. TR. Vol. II, Pages 28-46. Liberty Group and Gurley intentionally did a series of adjusted trades on each of the transactions, thus hiding the excessive markups and County's losses. TR. Vol. II, Pages 28-46. The information furnished to the County regarding these 13 transactions falsely led the County to believe it was making a very small profit. This false information was discovered when the State Auditor of New Mexico audited the County's account with Liberty Group on the 7th day of January, 1988. Plaintiff's Exhibit No. 62 Admitted into evidence, TR. Vol. II, Page 78. As a result of this audit, the County Attorney wrote Liberty Group a letter dated January 19, 1988, attaching a portion of the State Auditor's report, Plaintiff's Exhibit No. 62, demanding a return of the County's monies in the sum of $208,131.61. Plaintiff's Exhibit No. 46. Admitted into evidence, TR. Vol. I, Page 106. *Doyle Holmes, President of Liberty Capital Markets, Inc.*, replied to Baggett's letter, refusing to return any monies, and falsely trying to mislead County that the $208,000 was one side of an adjusted trade where the "broker-dealer acting as a principal sells a security to a customer

at a mark-up which reflects not only the current market value of the security, but also the loss incurred by the broker-dealer in an earlier or simultaneous transaction, in which the broker-dealer acting as a principal purchases a security from the same customer at a price above the prevailing market price." He tried to persuade the County to believe that it was Liberty Group that had suffered losses, and intimated in the letter that the SEC, the NASD, and the Securities Division of the State of New Mexico reviewed Liberty Group and Liberty Capital Markets' practice of conducting adjusted trades in the limited circumstances discussed above, and had taken no action. Holmes and Liberty Capital Markets asserted in Holmes' letter, "To date, neither the SEC, the NASD, nor the Division has apprised Liberty Group of any irregularity or illegality in the manner in which these trades were conducted." Plaintiff's Exhibit No. 47. Admittted into evidence, TR. Vol. I, Page 27. Holmes admitted these investigations had been conducted, and that he had not disclosed the outcome of the State's investigation to County. TR. Vol. II, Pages 121-123.[1]

On January 8, 1988, prior to the filing of this suit, Liberty Group and Liberty Capital Markets filed the amended Form BD with the NASD and the New Mexico Securities Division, certifying Liberty Capital Markets as successor in interest to Liberty Group had assumed

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[1] An adjusted trade is a practice and/or scheme whereby there is a contemporaneous purchase and sale of securities. Both the purchase and the sale are executed at prices away from the current market price. The sales transaction is executed in a manner to avoid recognition of losses; the purchase is executed at a price that is greater than the actual market price which incorporates an excessive mark up as well as recoups the adjusted loss from the prior sales. Such a practice is a fraudulent scheme under Sec. 10b of the Exchange Act of 1934 and Rule 10(b)(5) of the S.E.C. *In Re Transamerica Securities, Inc.* S.E.C. Administrative Proceeding No. 3-5810. *Findings and Order Imposing Remedial Sanctions, Dist. Conduct Committee for District No. 25 v. Liberty Capital Markets, Inc., et. al.* Complaint No. LA-4248.

and transferred all assets and liabilities. Plaintiff's Exhibit No. 39. Admitted into evidence, TR. Vol. I, Page 27. Thereafter, on March 8, 1988, the County filed suit in the New Mexico State Court. This cause was removed to the Federal District Court for the District of New Mexico, where trial by jury was held. Prior to the jury retiring, Defendants' attorney objected to the Trial Court's Jury Instruction No. 24 with respect to the scienter under 10b-5: TR. Vol. IV, Pages 56-57.

> "In Instruction number 24, I do note that it is an incorrect statement of the law with respect to 10b-5, with respect to the scienter element in the portion which reads: . . . 'he should have realized their significance in the making of an investment decision, or knew of the existence of material facts which were not disclosed although he knew that knowledge of those facts would be necessary to make his other statements not misleading.'
>
> The scienter element requires an intent to deceive, manipulate or defraud. I think under the Hurtzfielder (Phonetic) case that you have to show something more than this, which would be more of a simplest negligence standard instead of a gross negligence standard."

The objection was overruled by the Trial Court. The jury returned its verdict against Liberty Group, Gurley, and Holmes, finding they violated Rule 10b-5, and assessed damages at $188,223.09. The jury further found Liberty Group and Gurley violated RICO.

Judgment was entered on August 28, 1990, R. 15, Page 228 awarding reasonable attorney's fees, as provided by RICO. This judgment mistakenly omitted the law of the case that Liberty Capital Markets was the successor in interest of Liberty Group and had assumed all of its liabilities. R. 15, Page 228. Plaintiff filed a Motion pursuant to Fed. R. Civ. P. Rule 59 to correct the judgment and allow treble damages, attorney's fees, and to include Liberty Capital Markets as successor in interest to Liberty Group

and liable for the damages sustained by County. The trial court granted this motion and, accordingly, amended the judgment. Memorandum Opinion and Order, Appendix B, and R. 18, Page 268.

Defendants filed a motion for a J.N.O.V. and new trial with the Trial Court, raising the question: Whether an individual Limited Partnership defendant, whose enterprise affairs were conducted through racketeering activities be immune from prosecution under 18 U.S.C. 1962(c), RICO, because the person charged must be distinct from the enterprise which profited from its own racketeering activities. Defendants further objected on the grounds that the instruction allowed the jury to find liability based on negligence and because it failed to define recklessness, an omission that defendants now claim is highly prejudicial. The Trial Court in its Opinion dated November 1, 1962, Appendix B, denied the motion for a new trial. The Tenth Circuit Court of Appeals reversed the Trial Court's decision and granted a new trial on the 10b-5 liability issue.

The Tenth Circuit further reversed the RICO decision, holding: "The required separation between the RICO Enterprise and the defendant Liberty Group was not established and JNOV should have been granted to Liberty Group as to any liability under Section 1962(c)."

REASONS FOR GRANTING THE WRIT

I. THE COURTS ARE DIVIDED ON THE QUESTION

Congress enacted the Racketeer Influenced and Corrupt Organizations Act (RICO) 18 U.S.C. Section 1961-1968 (1982). Congress found that "organized crime in the United States is a highly sophisticated, diversified and widespread activity that annually drains billions of dollars from America's economy by unlawful conduct and the illegal use of force, fraud, and corruption. Congressional Statement of Findings and Purpose, Pub. L. No. 91-452, 84 Stat. 922 (1970).[2]

Section 1962 of RICO prohibits a "person" from investing, acquiring or operating an "enterprise" through a "pattern of racketeering activity". Widely acknowledged as one of the broadest federal statutes, *See* e.g., Strasser, Prosecutors, Private Bar Find New Uses for RICO, Nat'l. L.J., September 28, 1987, at 18, Col. 1 (RICO "a bit like the atomic bomb"). Many courts have

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[2] Congressional Statement of Findings and Purpose. Pub. L. No. 91-452, 84 Stat. 922 (1970). (Finding (1)), other findings: (2) organized crime derives a major portion of its power through money obtained from such illegal endeavors as syndicated gambling, loan sharking, the theft and fencing of property, the importation and distribution of narcotics and other dangerous drugs, and other forms of social exploitation; (3) this money and power are increasingly used to infiltrate and corrupt legitimate business and labor unions and to subvert and corrupt our democratic processes; (4) organized crime activities in the United States weaken the stability of the Nation's economic system, harm innocent investors and competing organizations, interfere with free competition, seriously burden interstate and foreign commerce, threaten the domestic security, and undermine the general welfare of the Nation and its citizens; and (5) organized crime continues to grow because of defects in the evidence gathering process of the law inhibiting the development of the legally admissible evidence necessary to bring criminal and other sanctions or remedies to beat the unlawful activities of those engaged in organized crime and because the sanctions and remedies available to the Government are unnecessarily limited in scope and impact.

atempted to limit its scope. Notably those restrictive judicial interpretations that have reached the Supreme Court have been struck down.[3]

As a general proposition, however, the civil remedies could be useful in eradicating organized crime from the social fabric on whether the enterprise be ostensibly legitimate or admittedly criminal. The aim is to divest the association of the fruits of its ill-gotten gains. Even if one or more of the civil remedies might be inapplicable to a particular illegitimate enterprise, the fact would not serve to limit the enterprise concept. *U.S. v. Turkette*, 452 U.S. 576 (1981).

Many of the lower courts, as the 10th Circuit in this case, have adopted the restrictive judicial interpretation of 1962(c) that the enterprise cannot be the same as the person.

The questions presented by this case is a question of federal law involving the 18 U.S.C. 1961(4). The United States Court of Appeals and the United States District Courts which have considered the question have rendered conflicting decisions.

The Eleventh Circuit repudiated the person-enterprise rule in a criminal case. In *United States v. Hartley*, the

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[3] *Sedima, S.P.R.L. v. Imrex Co.*, 741 F.2d 482 (2d Cir. 1984) (criminal convictions for predicate acts must precede private civil suit for RICO violation; plaintiff must allege "racketeering injury" somehow distinct from that directly caused by predicate acts), rev'd. 473 U.S. 479 (1985); *United States v. Turkette*, 632 F.2d 896 (1st Cir. 1980) (RICO "enterprise" does not include individuals who engage exclusively in criminal activity), rev'd. 452 U.S. 576 (1981). See also *Russello v. United States*, 464 U.S. 16 (1983) (RICO is purposefully broad); *Agency Holding Corp. v. Malley-Duff & Assoc., Inc.*, 107 S. Ct. 2759 (1987) (4-year federal Clayton Act statute of limitations applies to RICO); *Shearson-American Express, Inc. v. McMahon*, 107 S. Ct. 2332 (1987) (civil RICO claims are arbitrable). *H. & J., Inc. v. Northwestern Bell Telephone Co.*, 829 F.2d 648 (8th Cir. 1987) (Predicate acts constituting part of a single scheme can never support a cause of action under RICO.) rev'd 492 U.S. 229.

United States Court of Appeals for the Eleventh Circuit concluded that "a corporation may be simultaneously both a defendant and the enterprise under RICO". *United States v. Hartley*, 678 F.2d 961 (11th Cir. 1982). The defendants in *Hartley* were convicted of conspiracy, mail fraud, violation of National Stolen Property Act, and Section 1962(c) of RICO. Upholding the RICO conviction that "if an individual were named as the enterprise, and a group of persons engaged in a pattern of racketeering activities with that individual, it would defy reason to suggest that the central figure (the enterprise) could not also be prosecuted under RICO. The *Haroco* court found the comparison to an association in fact unpersuasive, *Haroco v. American National Bank*, 747 F.2d 384, 401 (7th Cir. 1984). The Federal District Court in *U.S. v. Benny*, 559 F. Supp. 264 (N.D. CA. 1983). The *Benny* court also repudiated the person-enterprise rule, stating:

> ". . . if an individual defendant/enterprise cannot be prosecuted, he entirely escapes responsibility under RICO. Nothing in the statute implies that an individual defendant, whose affairs constitute the enterprise, should automatically be immune from prosecution under RICO. Although the defendant insists that he does not seek automatic immunity, such immunity would surely be the logical and inevitable result of this position. It may be true, arguendo, that Congress did not primarily intend to reach the 'lone racketeer' when it adopted RICO; yet it did clearly specify that such a single individual could be prosecuted if he conducted an enterprise through racketeering activities. And where the statutory language is unambiguous, in the absence of a clearly expressed legislative intent to the contrary, that language must ordinarily be regarded as conclusive." *Albernaz v. U.S.*, 450 U.S. 333 (1981); *United States v. LeFavre*, 507 F.2d 1288 (4th Cir. 1974), *cert. denied*, 420 U.S. 1004 (1975). If *Benny's* position were to prevail, he alone would escape prosecution; his co-defendants would still face RICO charges. Hence, the person whose business was

> at the core of the racketeering activity would be immunized, while those persons who worked for the enterprise could be prosecuted. Surely Congress could not have intended such an absurd and unjust result.

Indeed, two United States Courts of Appeal have decided cases recognizing the person-enterprise rule and also have in other cases recognized exceptions to the rule. The United States Court of Appeals for the 7th Circuit in *Masi v. Ford City Bank and Trust Company*, 779 F.2d 397 (7th Cir. 1985) repudiated the person-enterprise rule even though the 7th Circuit Court in *Haroco, supra*, held to the contrary. The *Masi* court in so ruling, stated:

> ". . . The district court dismissed Masi's RICO count because he brought this action against only Ford City Bank which, the district court believed, could not be both the 'person' and the 'enterprise' seemingly required by section 1962. In the time between the district court opinion and this appeal, this Court decided *Haroco, Inc. v. American National Bank and Trust Company of Chicago*, 747 F.2d 384 (1984), aff'd, 473 U.S. 606, 05 S. Ct. 3291, 87 L. Ed. 2d 437 (1985). In that case, this court analyzed the necessary relationship between a person and an enterprise under the different subsections of 18 U.S.C. Section 1962. Id. at 399-402. We held that subsection (c) did require separate entities as the person and the enterprise but then stated:
>
> > 'However, a corporation-enterprise may be held liable under subsection (a) when the corporation is also a perpetrator. As we parse subsection (a), a "person" (such as a corporation-enterprise) acts unlawfully if it receives income derived directly or indirectly from a pattern of racketeering activity in which the person has participated as a principal within the meaning of 18 U.S.C. Section 2, and if the person uses the income in the establishment or operation of an enterprise affecting commerce. Subsection (a) does not contain any of the language in subsection (c) which

> suggests that the liable person and the enterprise must be separate. Under subsection (a), therefore, the liable person may be a corporation using the proceeds of a pattern of racketeering activity in its operations. The approach to subsection (a) thus makes the corporation-enterprise liable under RICO when the corporation is actually the direct or indirect beneficiary of the pattern of racketeering activity, but not when it is merely the victim, prize, or passive instrument of racketeering. This result is in accord with the primary purpose of RICO, which, after all, is to reach those who ultimately profit from racketeering, not those who are victimized by it. [Emphasis added]

> Because the parties in *Haroco* elected not to appeal their 1962(a) claim, id. at 402 n.21, this paragraph is essentially dicta. However, we adopt it as our holding because of the reasoning expressed in Haroco and because we find that this literal reading of the statute is in accord with the Supreme Court's approach in *Sedima, S.P.R.L. v. Imrex Co., Inc.*, 473 U.S. 479, 105 S. Ct. 3275, 87 L. Ed. 2d 346 (1985).
>
> Therefore, we conclude that the district court must be reversed and that Masi may proceed against the Bank as both the person and the enterprise allegedly using the income derived from racketeering activity. In so doing we express no opinion on the merits of plaintiff Masi's 1962(a) claim or the validity of the predicate acts upon which the claim is based."

Again, the United States Court of Appeals for the 10th Circuit has rendered conflicting decisions on the person-enterprise rule. In the case at bar, the 10th Circuit Court reviewed all of the evidence and found:

> "The required separation between the RICO enterprise and the defendant Liberty Group was not established and JNOV should have been granted to Liberty Group as to any liability under Section 1962(c).

> With respect to the defendant Gurley, he may be a person under 1962(c). Thus, the defect in proving a 'person' separate from the 'enterprise' is not present with respect to Gurley and a new trial for such defect is not required."

In the case at bar, the Limited Partnership was the perpetrator of the fraud and received all of the ill gotten gains of the fraud. The 10th Circuit in *Garbade v. Great Divide Mining and Milling Corporation*, 831 F.2d 212 (10th Cir. 1987), held:

> "The 'person' and 'enterprise' combination liability can only occur when the corporation actually is the direct beneficiary of the pattern of racketeering activity, *Haroco, Inc. v. American Nat'l. Bank & Trust Co.*, 747 F.2d 384 (7th Cir.); also, where it is to disgorge illegally obtained proceeds, *Masi v. Ford City Bank & Trust Co.*, 779 F.2d 397 (7th Cir.); or where the statute seeks to reach the proceeds of illegal activities *Schreiber Distributing Co. v. Serv-Well Furniture Co.*, 806 F.2d 1393 (9th Cir.)."

The Ninth Circuit repudiated the person-enterprise rule in a civil case under Section 1962(c). *In Schreiber Distributing Co. v. Serv-Well Furniture Co., Inc.*, 806 F.2d 1393 (9th Cir. 1986), reversed the trial court, stating:

> "V. Conclusion
>
> The district court erred in dismissing Schreiber's RICO claims for: . . .
>
> 4. failure to allege a 'person' separate and distinct from 'enterprise' under section 1962(a), (b), and (c) with respect to the individual defendants John Lee and James Lee."

The court's reasoning in *Schreiber, supra*, was:

> " 'Logic dictates that a corporation, receiving income from a pattern of racketeering in which it has participated as a principal, can invest that income in its own operations.' *Pennsylvania v. Derry Construction*

> *Co.*, 617 F.Supp. 940, 943 (W.D. Pa. 1985). Thus, we hold that where a corporation engages in racketeering activities and is the direct or indirect beneficiary of the pattern of racketeering activity, it can be both the 'person' and the 'enterprise' under section 1962(a). *Haroco*, 747 F.2d at 402."

Again, in *McCullough v. Sutter*, 757 F.2d 142 (7th Cir. 1985), the 7th Circuit Court of Appeals held that the enterprise and the person can be the same under 1962(c). Here, the Court pointed out that a sole proprietorship enterprise is not the same as a corporation enterprise in that:

> "If the one-man band incorporates, it gets some legal protection from the corporate form, such a limited liability; and is just this sort of legal shield for illegal activity that RICO tries to pierce. A one-man band that does not incorporate that merely operates as a proprietorship, gains no legal protection from the form in which it has chosen to do business; the man and the proprietorship really are the same entity in law and fact. But if the man has employees or associates, the enterprise is distinct from him, and it makes no difference, so far as we can see, what legal form the enterprise takes. The only important thing is that it be either formally (as when there is a corporation) or practically (as when there are other people besides the proprietor working in the organization) separable from the individual."

In the case at bar, we have a Limited Partnership composed of two general partners, namely, Liberty Partners and FMG Partners and Liberty Group, Ltd., which constitutes the enterprise. The general partners and the Limited Partnership received income from a pattern of racketeering activity and invested that income in its own operation. All that 1962(c) requires, as is said in *Haroco* and *McCullough*, *supra*, is "some separate distinct existence for the person and the enterprise, 747 F.2d at 402."

II. THE QUESTION PRESENTED IS AN IMPORTANT QUESTION OF FEDERAL LAW WHICH SHOULD BE RESOLVED BY THIS COURT

The issues raised in this case requires resolution by this Court for a number of reasons.

A. The Need for Uniformity in Application of Section 1962(c) of RICO

First, the conflict of decisions among the Circuit Courts of Appeals leaves unsettled the question of whether an individual Limited Partnership Defendant whose enterprise affairs were conducted through racketeering activities and received the benefits of such activity be immune from prosecution under 18 U.S.C. 1962 (c), RICO, because the person charged must be distinct from the enterprise which profited from its own racketeering activities. This question is an important one which should be resolved by this Court due to the large number of racketeering activities by the enterprise which profits from its own racketeering activities. There is need for uniform application of the provisions of 1962(c) of RICO.

B. The Need for Resolution of the Impact of the Definition of "Enterprise" Under Section 1962(c) of RICO

Second, the decision below, that an enterprise must be separate and distinct from the person, creates a conflict between the immunity to prosecution under Section 1962(a) and Section 1962(c) which should be settled by this Court. It is not at all clear that Congress contemplated the kind of distinction required by the person-enterprise rule in adopting the language of Section 1962(c). The consequences of the rule adopted by the Tenth Circuit in its decision are clearly contrary to the statute's purpose. RICO provided enhanced civil sanctions for those "persons" [4] that acquire or operate an "enter-

[4] 18 U.S.C. Section 1961(3) (1982) provides:

"Person includes any individual or entity capable of holding a legal or beneficial interest in property."

prise"[5] through a "pattern of racketeering activity"; in short, for those who engaged in "organized crime" in its generic, rather than stereotypical sense. *Sedima, S.P.R.L. v. Imrex Co., supra.*

The statutory definition of "enterprise" is in direct conflict with the decision of the Tenth Circuit in the case at bar and also with the other courts adhering to the person-enterprise rule.

C. The Need for a Uniform Rule Within Section 1962(c)

Last, the decision below expressly creates a different rule which automatically immunizes from prosecution the enterprise entity which is the perpetrator of the racketeering activity and benefited from the activity while the employed person can be prosecuted. Surely Congress did not intend this ridiculous circumstance. *Innocence by association: Entities and the Enterprise Rule Under RICO.* 63 Notre Dame L. Rev. 179 (1988); *U.S. v. Benny, supra.*

D. An Alternative Approach

There is need for a clear articulation of the standards of entity liability under RICO. To date, the courts have not only developed their own indiscriminate interpretation of RICO, but inspired others to do the same. Defining the appropriate criteria involves avoiding two equally undesirable outcomes. On the one hand, complete denial of the existence of corporations and other entities that conduct their own affairs through racketeering reduces the statute's effectiveness toward "providing enhanced sanctions and new remedies to deal with unlawful activities of those engaged in organized crime". *Congressional Statement of Findings and Purpose*, Pub. L. No. 91-452,

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[5] 18 U.S.C. Section 1961(4) (1982) provides:

"Enterprise" includes any individual, partnership, corporation, association, or other legal entity and any union or group of individuals associated in fact although not a legal entity."

84 Stat. 922 (1970). On the other hand, it would be a perverse result indeed if RICO, the statute designated to eliminate the influence of organized crime, were to become the vehicle for allocating the damage done by racketeering activity as an inevitable cost of doing legitimate business. *Civil RICO and the Misapplication of Vicarious Corporate Liability*, 65 Boston U.L. Rev. 561, 600 (1985).

Achieving the proper medium between these two extremes requires understanding two equally complex schemes. On the one hand, there are common legal distinctions between theories of liability. On the other hand, there is RICO.

In their attempt to limit corporate liability under RICO to its proper bounds, courts appear to have sought opportunities to turn the statute's language against itself, rather than to adapt traditional principals of entity liability to RICO. Thus, because a corporation or a limited partnership fits the statutory definitions of both "person" and "enterprise", courts have pondered whether the same corporation or limited partnership may be both a "person" and an "enterprise" at the same time. Their answer to this question appears to be "sometimes", i.e., "under some subsections", which subsections vary with the jurisdiction. With respect to subsection 1962(c), however, the answer is more uniform. Under that subsection, not only must there be a "person" and an "enterprise", but there must be an employment or associative relationship between the two. As a result, courts have also posited the question whether a corporation or limited partnership may be "employed by or associative itself". Their answer to this question appears to be a flat "No". In sum, the majority approach has been to contemplate whether certain person-enterprise relationships may exist in statutory parlance, rather than to articulate when the actual existence of such relationship may result in statutory liability.

The proper inquiry is not whether a corporation may be both the "person" and the "enterprise" at the same time. When a corporation or limited partnership is precluded from playing both roles, it cannot violate RICO by investing in itself or conducting its own affairs through criminal activity. Nor is the proper question whether a corporation or limited partnership may be employed by or associated with itself through an employee. A corporation or limited partnership can act only through its employees and agents. Phrasing the issue in the majority's terms distorts this reality. The question should be whether, if a person is "employed by or associated with" the corporation or limited partnership, the corporation or limited partnership may be liable for that "person's" RICO violation.

Principals of Agency and respondeat superior have historically provided the answer to the question whether a corporation may be liable for the illegal actions of its employees and agents. Courts appear to recognize, however, a distinction between the way agency and respondeat superior principles have been applied in criminal cases versus civil cases. In a civil antitrust case, for example, the Supreme Court suggested that vicarious civil liability may be imposed upon a corporation even though the employee may have acted without intent to benefit the corporation. *American Soc. of Mech. Eng'rs. v. Hydrolevel Corp.*, 456 U.S. 556, 567-68 (1982). Courts hearing criminal cases, however, have historically insisted upon an intent to benefit requirement. *New York Central & H.R.R. v. United States*, 212 U.S. 481, 494-99 (1909). *See* also *Restatement (Second) of Agency*, Sections 219(d), 248-249, 261-62 (1958); *Commonwealth v. Beneficial Finance Co.*, 360 Mass. 188, 275 N.E.2d 33 (1971).

Generally, the criminal law attributes to the corporation the unlawful conduct of employees or agents who act within the scope of their employment or authority and with the intent to benefit the corporation. Conversely,

actions taken by employees or agent for purely personal motives are normally considered to be their actions alone. *Standard Oil Co. of Texas v. United States*, 307 F.2d 120, 128 (5th Cir. 1962). When corporations are themselves victims of their employees' acts of racketeering, then the established doctrine of criminal law excuses the corporation from liability. *Gelbardi v. United States*, 287 U.S. 112 (1932); *United States v. Spitler*, 800 F.2d 1267, 1275-1279 (4th Cir. 1986). The penal component of Civil RICO's treble damages remedy and independently criminal character of the underlying acts of racketeering RICO requires, favor the application of such criminal standards of entity liability to all RICO cases, civil and criminal.

III. THE TRIAL COURT PROPERLY INSTRUCTED THE JURY ON REQUISITE MENTAL STATE FOR LIABILITY REQUIRED UNDER A RULE 10b-5 CLAIM PROMULGATED UNDER THE SECURITIES AND EXCHANGE ACT OF 1934 17 C.F.R. 240.10b-5(b)

The Trial Court gave the following jury instructions. Trial Court's Jury Instruction No. 24:

> "The plaintiff, in order to recover on his 10B-5 claim must show that the defendant acted knowingly, that is, with a mental state embracing intent to deceive, manipulate, or defraud. In order to establish this element the plaintiff must prove by the greater weight of the evidence that the defendant made material statements which he knew to be false, or made statements with reckless disregard for their truth or falsity, or knew of the existence of material facts which were not disclosed and he should have realized their significance in the making of an investment decision, or knew of the existence of material facts which were not disclosed although he knew that knowledge of those facts would be necessary to make his other statements not misleading."

The Defendants objected that this instruction was an incorrect statement of the law. They asserted, "the sci-

enter element requires an intent to deceive, manipulate, or defraud. I think that under the [Hochfelder] case that you would have to show more than this, which would be more of a simplest [sic] negligence standard instead of a gross negligence standard." The objection was overruled.

The Trial Court specifically mandated in its instruction that, "The Plaintiff, in order to recover on his 10b-5 claim, *must show that the defendant acted knowingly, that is, with a mental state embracing intent to deceive, manipulate, or defraud.* (emphasis supplied) The jury in its verdict found that the defendant acted with this requisite mental state. Under this charge that the jury "must show that the defendant acted knowingly, that is with a mental state embracing intent to deceive, manipulate or defraud", we do not believe that Hochfelder required more than this. Accordingly, Judge Mechem's charge to the jury was not reversible error or that fundamental injustice occurred. *U.S. v. Chiarella*, 588 F.2d 1358 (2nd Cir. 1978), rev'd. on other grounds, 445 U.S. 222 (1980).

Under this instruction it is clear that, before the Plaintiff could recover on its 10b-5 claim, it was mandatory that the jury find the defendant acted knowingly, that is with a mental state embracing intent to deceive, manipulae or defraud. If one acts intentionally, his acts are more than simplistic negligence.

Throughout the history of this case, the Plaintiffs proceeded on a theory of liability premised on intentional, knowing conduct, and that defendants acted with intent to defraud or intentional misconduct. The definition of scieter as outlined in the relevant cases is "a mental state embracing intent to deceive, manipulate or defraud". *Ernst v. Hochfelder*, 425 U.S. 185, 193 (1976). Thus, the wording of the instruction was taken almost verbatim from the definition of scienter as stated in *Hochfelder, id.*

It is important to point out at this time that defendants' objection to the instruction merely stated:

> "The Scienter element requires an intent to deceive, manipulate or defraud. I think under the [Hockfielder] that you would have to show more than this, which would be more of a simplest [sic] negligence standard instead of a gross negligence standard."

There was no objection before the case went to the jury for the failure of the court to define "Recklessness" in its instructions to the jury.

A. Defendants' Objection to the Instruction Was Not Sufficient Under Fed.R.Civ.P. Rule 51 To Preserve the Question for Review

Fed.R.Civ.P. Rule 51 is very specific as to how the objection is to be stated in order to preserve the matter for review. The rule makes it mandatory before a party may assign as error the giving or failure to give an instruction, the party must object and state distinctly the matter objected to and the grounds of the objection. The defendants failed to object to the court's failure to give their requested instruction on Recklessness, or that the court failed to instruct on the definition Recklessness. This question was first raised in their motion for a JNOV or in the alternative a new trial, after the case was given to the jury and the jury had rendered their verdict.

The Trial Court noted this in its Memorandum Opinion and Order of November 1, 1990 at Page 15, Appendix B. P.27a. Judge Mechem stated:

> "Defendants now object on the grounds that the instruction allowed the jury to find liability based on negligence and because it failed to define recklessness, an omission that defendants now claim is highly prejudicial. However, during objections to instructions at trial, defendants' objection was that '[t]he scienter element requires an intent to deceive, manipulate, or defraud . . . . [Y]ou have to show some-

> thing more than this, which would be more of a simplest negligence standard instead of a gross negligence standard.' Defendants did not object to the omission of a recklessness definition at trial. No party can claim error in the failure to give an instruction unless he objects to it before the jury retires. Fed.R.Civ.P. 51 and *Zimmerman v. First Federal Savings & Loan Ass'n*, 848 F.2d 1047 (10th Cir. 1988)."

The Trial Court took the same wording in its Scienter Instruction No. 24 from Defendants' Requested Jury Instruction No. 32. Appendix C, Page 30a. The Trial court did not give the full Requested Instruction No. 32; the portion of the instruction on Recklessness was deleted from the Court's Instruction No. 24, Appendix C, Page 30a, Defendants' Requested Jury Instruction No. 32.

Regarding defendants' claim that the language in Instruction No. 24 was eroneous, "[a] party who claims plain error has the heavy burden of demonstrating fundamental injustice. *Clegg v. Conk*, 507 F.2d 1351 (10th Cir. 1974), *cert. denied*, 442 U.S. 1007 (1975). In *Clegg*, the Tenth Circuit addressed the question of whether the jury instruction adequately informed the jury on the issue of scienter in a Rule 10b-5 claim. The Tenth Circuit found that:

> "If the trial court had charged the jury in effect that untrue statements or omissions resulting from mere negligence *without any manner or scienter, conscious fault, intention or recklessness*, would have justified a recovery against Conk, this would have been fundamentally or palpably wrong and subject to correction here despite question as to the sufficiency of exceptions below.[17]

[17] Cf. Fed. R. Cr. P. 52(b). See Hormel v. Helvering, 312 U.S. 552 (1941); Smith v. Welch, 189 F.2d 832 (10th Cir. 1951); State v. Neustadt, 149 F.2d 143 (10th Cir. 1945); National Fire Ins. Co. v. School Dist. No. 68, 115 F.2d 232 (10th Cir. 1940). Cf. Murphy v. Dyer, 409 F.2d 747 (10th Cir. 1969).

But for the very reason that the language of the Act tells us that such a charge would have represented a fundamental departure from its purpose and *implied that simple negligence would not be enough.*[18]

[18] See footnote 8 for the trial court's charge as to Conk.

To us there is an undoubtable implication of fault beyond mere carelessness in 'engaging in any device, scheme, or artifice to defraud or the making of untrue statements of material fact or omitting to state any material fact necessary in order to make statements made in the light of the circumstances not misleading.' Laymen, in the context of the other instructions, would be likely to sense this, even though there is ground for dispute among lawyers that 'untrue' statements and the 'misleading' of others by omissions to state material facts could result simply from innocent though negligent oversight.

There is nothing in the record to suggest that the jury was misled in this case in any fundamental sense. On the contrary, even the partial record placed before us suggests that the nature of the conduct on which appellant's liability must have been predicated, as distinguished from the type of conduct on the basis of which his codefendant was acquitted, was necessarily pursued knowingly and intentionally and with purpose to mislead. A party who claims error within the reach of Rule 51, Fed. R. Civ. P., cf. Rule 52 Fed. R. Cr. P., has the heavy burden of demonstrating fundamental injustice. This the plaintiff has not done.

We do not mean to suggest generally that submission of the issues in the statutory language is enough when a proper request to charge is submitted to the trial court or timely exception is taken to the instructions as given or to a failure to charge on the subject. Indeed the defendant protected by such a request or exception is entitled to have his theory of defense specifically submitted to the jury in the context of the particular [*1363] record facts and

consistently with the decisions of this court on the points under discussion.

> We hold that the instructions sufficiently recognized the requirement of 'scienter' or conscious fault to withstand an attack on the ground of fundamental error and that. beyond this, there was no request or exception preserving for review any technical deficiency." (emphasis supplied)

There was no timely and sufficient exceptions taken as to any instruction on the point. After the Instructions were given and the jury had rendered its verdict, the failure to instruct on Recklessness was objected to. This fell far short of a timely or effective exception to preserve the point in view of the absence of any fundamental error. Fed. R. Civ. P. Rule 51; *Clegg v. Conk, supra; Radio Corporation of America v. Radio Station KYFM, Inc.*, 424 F.2d 14 (10th Cir. 1970); *Smith v. Greyhound Lines, Inc.*, 382 F.2d 190 (10th Cir. 1967); *Great-West Life Assurance Company v. Levy*, 382 F.2d 357 (10th Cir. 1967); *Dunn v. St. Louis-San Francisco Railway Company*, 370 F.2d 681 (10th Cir. 1966).

CONCLUSION

Three important reasons exist for this court to resolve the question presented in this case.

First, the United States Courts of Appeals have divided on the question, resulting in lack of uniform application of whether a corporation or limited partnership may be simultaneously both a defendant and the enterprise under RICO.

Second, the decision below, that an enterprise must be separate and distinct from the person, creates a conflict between the immunity to prosecution under Section 1962(a) and 1962(c) which should be settled by this court. It is not at all clear that Congress contemplated

the kind of distinction required by the person-enterprise rule in adopting the language of Section 1962(c).

Last, the consequences of the rule adopted by the Tenth Circuit in its decision are clearly contrary to the Statute's purpose.

WHEREFORE, Petitioner respectfully prays that a Writ of Certiorari be granted.

Respectfully submitted,

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